



Financial Management Report as of SEPTEMBER 30, 2010

AT A GLANCE:

2010 General Fund revenue would be slightly ahead of the same period in 2009 except for the timing of EMS levy receipts. (page 3)

2010 Sales tax revenue continues positive trend (page 5)

Building permits remain down and Planning fees still positive (page 4)

City recognized for revised debt management policy (page 2 sidebar)

It's official—the recession is over—but can we stop worrying? (pages 7-8)

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Summary of All Operating Funds: *Revenue*

- General Fund** actual 2010 revenue is **0.7 percent behind** the same period last year. However, the timing of the payment from the Emergency Medical Services (EMS) levy by King County skews the comparison—normalizing for this factor, revenue would be about 0.4 percent ahead of the same period last year. Increased revenue from sales and property taxes, franchise fees, and internal charges are generally offset by declines in utility taxes and building revenue, as well as significantly lower interest earnings revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- Water Sewer Operating Fund** actual 2010 revenue is **1.2 percent ahead** of the same period last year primarily due to the higher water and sewer rates and despite lower revenue from new connection fees. The impact of reduced water usage from the cooler and damper spring and summer offset some of the effects of higher water and sewer rates.
- Surface Water Management Fund** actual 2010 revenue is **3.9 percent lower** compared to the same period last year primarily due to timing of revenue collection. Rates are paid through property taxes, which are primarily received in April and October and can be somewhat volatile from year to year.
- Solid Waste Fund** actual 2010 revenue is **1.2 percent lower** compared to the same period last year due to normal variations in timing of revenue collection.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2009	9/30/2010	% Change	2009	2010	% Change	2009	2010
General Gov't Operating:								
General Fund	37,320,816	37,072,417	-0.7%	54,549,760	54,699,354	0.3%	68.4%	67.8%
Other General Gov't Operating Funds	11,931,479	11,311,160	-5.2%	16,563,457	15,655,990	-5.5%	72.0%	72.2%
Total General Gov't Operating	49,252,295	48,383,577	-1.8%	71,113,217	70,355,344	-1.1%	69.3%	68.8%
Utilities:								
Water/Sewer Operating Fund	12,950,092	13,105,620	1.2%	19,807,210	20,660,066	4.3%	65.4%	63.4%
Surface Water Management Fund	3,024,446	2,907,955	-3.9%	5,350,962	5,270,500	-1.5%	56.5%	55.2%
Solid Waste Fund	6,362,545	6,288,616	-1.2%	8,612,724	8,627,630	0.2%	73.9%	72.9%
Total Utilities	22,337,083	22,302,191	-0.2%	33,770,896	34,558,196	2.3%	66.1%	64.5%
Total All Operating Funds	71,589,378	70,685,768	-1.3%	104,884,113	104,913,540	0.0%	68.3%	67.4%

Budgeted and actual revenues exclude resources forward and interfund transfers.



Kirkland Recognized for its Debt Management Policy

City is one out of only two certified in the nation by the Association of Public Treasurers in 2010.

The Association of Public Treasurers of the United States and Canada (APT US&C) has certified the City of Kirkland's revised Debt Management Policy. On September 21, 2010 the City Council approved the revised policy for the City by adopting Resolution No. 4837. The policy guides the City's process related to the use of different types of debt to finance projects included in the City's Capital Improvement Program.

The amount of debt issued by the city is an important factor in measuring its financial performance and condition. Proper use and management of borrowing can yield significant advantages. From a policy perspective, the City of Kirkland uses debt in two ways: (1) as a mechanism to equalize the costs of needed improvements to both present and future citizens; and (2) as a mechanism to reduce the immediate costs of substantial public improvements.

"The amount and process by which debt is issued by the City is an important factor in maintaining its sound financial condition," notes Tracey Dunlap, Finance Director. "This policy helps the City protect our credit quality and issue new debt to finance needed improvements responsibly." The City's current bond rating by Standard & Poor's is AAA; the highest achievable rating that indicates an extremely strong capacity to meet financial commitments.

The revised Debt Management Policy has been formatted according to the Government Finance Officers Association's (GFOA) recommended practices in the six following categories: 1) Uses of Debt; 2) Debt Limits; 3) Allowable Types of Debt; 4) Debt Structuring Practices; 5) Debt Issuance Practices and 6) Debt Management Practices.

Summary of All Operating Funds: *Expenditures*

- **General Fund** actual expenditures are **1.7 percent behind** last year primarily due to lower personnel and internal service costs and despite an increase in contracted services. A regional agency (NORCOM) began providing dispatch services as of July 1, 2009, which resulted in a shift from salaries and benefits to contracted services, which is the reason for the increased contracted costs and one of the reasons for reduced personnel costs. Personnel costs are also down due to reduced 2010 salaries taken by most employees (who received furlough days in return) as a budget reduction strategy, as well as reduction in staffing and lower overtime costs. The reduction in overtime costs is largely the result of the elimination of the dispatch staffing. To complicate comparisons even more, the City has started to hire staffing in 2010 (especially in the Police Department), in anticipation of providing services to the annexation area as of June 1, 2011. The annexation will add over 33,000 people and about 7 miles of land area. A more detailed analysis of General Fund expenditures by department is found on page 4.
- **Other Operating Funds** actual expenditures are **5.4 percent behind** the same period last year due to generally lower personnel costs and internal rates (primarily due to expenditure reductions), reduced Street operating supplies, lower facility utility costs, and the elimination of the lease payment for the municipal court building, which was purchased last year. Expenditures are behind the same period last year despite higher vehicle/equipment purchases. Facility utility costs are down, partially due to milder winter weather, but also from staff conservation efforts and the pay-off from investments in updated controls and equipment at various locations. Vehicle replacement costs vary year-to-year depending on the planned replacement cycle.
- **Water/Sewer Operating Fund** actual expenditures are **0.5 percent ahead** of the same period last year primarily due to an increase in charges to purchase water from the Cascade Water Alliance. There is a corresponding increase in revenue from increased water and sewer rates.
- **Surface Water Management Fund** actual expenditures are **3.2 percent ahead** of the same period last year due to higher personnel costs related to National Pollutant Discharge Elimination System (NPDES) requirements, which requires public outreach and monitoring of surface water discharge, and normal variability in the timing of payment for various services.
- **Solid Waste Fund** actual expenditures are **9.5 percent ahead** of the same period last year due to the timing of disposal contract billing payments. The monthly contract payments are significant, so timing differences between years can skew comparisons. Normalizing for this impact brings expenditures just slightly behind last year.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2009	9/30/2010	% Change	2009	2010	% Change	2009	2010
General Gov't Operating:								
General Fund	43,137,713	42,383,224	-1.7%	59,167,520	57,900,427	-2.1%	72.9%	73.2%
Other General Gov't Operating Funds	10,074,372	9,531,422	-5.4%	15,415,335	12,904,036	-16.3%	65.4%	73.9%
Total General Gov't Operating	53,212,085	51,914,646	-2.4%	74,582,855	70,804,463	-5.1%	71.3%	73.3%
Utilities:								
Water/Sewer Operating Fund	11,058,789	11,119,283	0.5%	15,555,212	15,903,927	2.2%	71.1%	69.9%
Surface Water Management Fund	2,319,007	2,393,964	3.2%	3,605,721	3,387,458	-6.1%	64.3%	70.7%
Solid Waste Fund	5,609,033	6,142,062	9.5%	8,455,673	8,596,408	1.7%	66.3%	71.4%
Total Utilities	18,986,829	19,655,309	3.5%	27,616,606	27,887,793	1.0%	68.8%	70.5%
Total All Operating Funds	72,198,914	71,569,955	-0.9%	102,199,461	98,692,256	-3.4%	70.6%	72.5%

Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and interfund transfers.

General Fund Revenue

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development-related fees.

- **Sales tax** revenue allocated to the General Fund for 2010 was adjusted to reflect lower projections as a result of the economic recession. However, actual revenue is **5.6 percent ahead** of the same period last year. A detailed analysis of **sales tax** revenue can be found starting on page 5.
- **Property tax** is **6.7 percent ahead** due to a planned reallocation from the Street Operating Fund in 2010.
- **Utility tax** actual revenue collection is **2.2 percent behind** the same period last year primarily due to significantly lower revenue from natural gas (down 25.2 percent) and electricity (down 1.6 percent) most likely the result of milder winter weather compared to the previous year along with lower natural gas rates. Water and sewer utility taxes are up from the same period last year reflecting higher utility rates, but revenues from these sources are still lagging budget expectations.
- **Other taxes** actual revenue is **21.8 percent behind** the same period last year due to lower gambling tax revenue.
- The **business licenses (base fee) and franchise fees** actual revenue is **8.1 percent ahead** of the same period last year primarily due to higher franchise fee revenue. The **revenue generating regulatory license fee** is **7.2 percent ahead** of the same period last year. This fee was restructured and substantially increased in 2009. The increase in 2010 is a combination of fully realizing the restructured fees, as well as changes in timing for renewal of larger employers, but revenue from this source is still lagging budget expectations.
- **Development-related fee** revenues, which collectively are **down 17.2 percent** compared to the same period in 2009 are experiencing contrasting trends. Compared to the same period last year, **building permits** are **31.4 percent lower** and **engineering services** revenue

- is **20.5 percent lower**, while **plan check revenue** is **ahead 18.1 percent** and **planning fees** revenue is **ahead 11.9 percent** due to a significant increase in pre-submittal process applications. The increase in the latter two revenues may be a hopeful sign of improvement in future development activity. Note this increase is in comparison to very low collections during the same period in 2009.
- Compared to the same period last year: **Grant** revenue is **56.4 percent higher** due to federal stimulus grants for court security, fire station window replacements and home energy reports contracted with Puget Sound Energy; **State shared revenue** is down 6.1 percent due to lower streamline sales tax mitigation revenue and despite higher liquor control board profits and liquor taxes (it should be noted that if one or both of the initiatives pass this fall to privatize liquor sales, the potential annual loss of future revenue is about \$350,000 from liquor profits); **Other intergovernmental services** revenue is **41.0 percent below** last year's actual due to the elimination of the contract providing dispatching services to other cities caused by the formation of NORCOM and despite an increase to revenue received from providing staffing to the regional Criminal Justice Training Center. As mentioned previously, the timing of revenue from the EMS Levy skews comparisons between years.
 - **Internal Charges** are **12.2 percent ahead** compared to the same period last year primarily due to an increase in capital project engineering charges.
 - **Miscellaneous** revenue is **69.9 percent behind** last year due to substantially lower interest earnings.
 - **Other financing sources** are behind last year due to the funding transferred from other funds in 2009 to balance the 2009-10 budget.

General Fund 2010 revenues would be about \$165,000 ahead of the same period in 2009, normalized for the timing of the EMS Levy revenue.

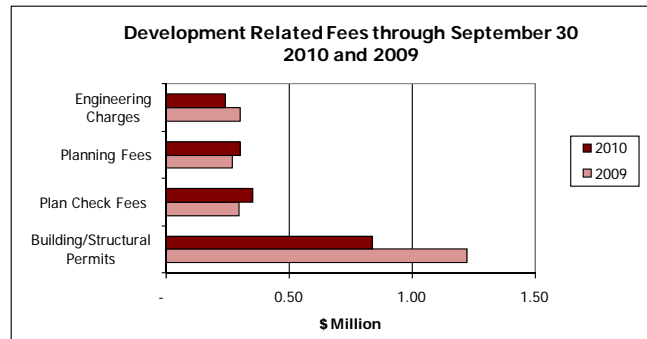
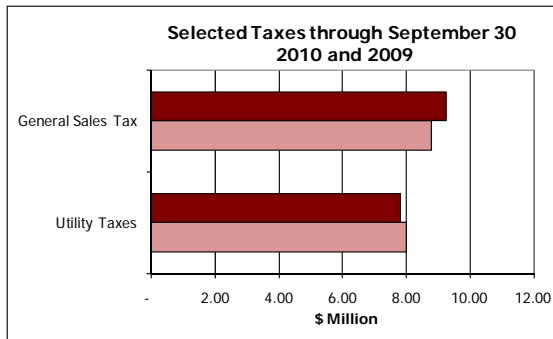
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 377 of the City's 474 regular (full-time equivalent) employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	9/30/2009	9/30/2010	% Change	2009	2010	% Change	2009	2010
Taxes:								
Retail Sales Tax: General	8,779,384	9,266,964	5.6%	11,564,551	11,464,179	-0.9%	75.9%	80.8%
Retail Sales Tax: Criminal Justice	725,271	704,089	-2.9%	1,107,000	1,129,140	2.0%	65.5%	62.4%
Property Tax	5,063,439	5,400,369	6.7%	9,264,941	9,904,815	6.9%	54.7%	54.5%
Utility Taxes	7,977,858	7,801,302	-2.2%	10,604,676	10,965,526	3.4%	75.2%	71.1%
Rev Generating Regulatory License	1,521,270	1,631,331	7.2%	2,599,920	2,567,468	-1.2%	58.5%	63.5%
Other Taxes	328,219	256,771	-21.8%	591,779	463,900	-21.6%	55.5%	55.4%
Total Taxes	24,395,441	25,060,826	2.7%	35,732,867	36,495,028	2.1%	68.3%	68.7%
Licenses & Permits:								
Building, Structural & Equipment Permits	1,223,389	839,616	-31.4%	1,645,600	1,436,990	-12.7%	74.3%	58.4%
Business Licenses/Franchise Fees	1,260,598	1,362,491	8.1%	1,654,903	1,720,921	4.0%	76.2%	79.2%
Other Licenses & Permits	144,918	156,998	8.3%	183,500	175,460	-4.4%	79.0%	89.5%
Total Licenses & Permits	2,628,905	2,359,105	-10.3%	3,484,003	3,333,371	-4.3%	75.5%	70.8%
Intergovernmental:								
Grants	222,281	347,588	56.4%	218,754	533,933	144.1%	101.6%	65.1%
State Shared Revenues & Entitlements	680,882	639,337	-6.1%	908,404	809,010	-10.9%	75.0%	79.0%
Fire District #41	1,967,464	1,760,590	N/A	3,850,077	3,598,238	N/A	51.1%	48.9%
EMS	419,199	-	N/A	836,938	866,231	N/A	50.1%	N/A
Other Intergovernmental Services	694,607	409,570	-41.0%	654,713	547,420	-16.4%	106.1%	74.8%
Total Intergovernmental	3,984,433	3,157,085	-20.8%	6,468,886	6,354,832	-1.8%	61.6%	49.7%
Charges for Services:								
Internal Charges	3,320,425	3,726,924	12.2%	4,905,963	4,707,822	-4.0%	67.7%	79.2%
Engineering Services	299,193	237,989	-20.5%	357,134	225,000	-37.0%	83.8%	105.8%
Plan Check Fee	296,740	350,587	18.1%	520,000	408,252	-21.5%	57.1%	85.9%
Planning Fees	268,459	300,369	11.9%	247,157	245,420	-0.7%	108.6%	122.4%
Other Charges for Services	629,262	614,760	-2.3%	756,426	742,937	-1.8%	83.2%	82.7%
Total Charges for Services	4,814,079	5,230,629	8.7%	6,786,680	6,329,431	-6.7%	70.9%	82.6%
Fines & Forfeits	1,030,513	1,124,185	9.1%	1,407,595	1,532,000	8.8%	73.2%	73.4%
Miscellaneous	467,445	140,587	-69.9%	669,729	654,692	-2.2%	69.8%	21.5%
Total Revenues	37,320,816	37,072,417	-0.7%	54,549,760	54,699,354	0.3%	68.4%	67.8%
Other Financing Sources:								
Interfund Transfers	2,987,543	1,917,159	N/A	3,899,053	2,248,530	N/A	76.6%	85.3%
Total Other Financing Sources	2,987,543	1,917,159	N/A	3,899,053	2,248,530	N/A	76.6%	85.3%
Total Resources	40,308,359	38,989,576	-3.3%	58,448,813	56,947,884	-2.6%	69.0%	68.5%

Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued*



General Fund Expenditures

General Fund Department Expenditures	Year-to-Date Actual			Budget			% of Budget	
	9/30/2009	9/30/2010	% Change	2009	2010	% Change	2009	2010
Non-Departmental	800,489	878,735	9.8%	1,254,877	1,413,802	12.7%	63.8%	62.2%
City Council	276,148	284,693	3.1%	353,175	353,130	0.0%	78.2%	80.6%
City Manager's Office	2,449,420	2,172,941	-11.3%	3,434,631	3,087,640	-10.1%	71.3%	70.4%
Human Resources	770,600	759,065	-1.5%	1,081,720	1,124,972	4.0%	71.2%	67.5%
City Attorney's Office	752,415	728,571	-3.2%	993,790	974,121	-2.0%	75.7%	74.8%
Parks & Community Services	5,252,916	4,953,240	-5.7%	7,621,687	6,703,551	-12.0%	68.9%	73.9%
Public Works (Engineering)	2,519,198	2,357,623	-6.4%	3,629,985	3,325,385	-8.4%	69.4%	70.9%
Finance and Administration	2,672,054	2,610,521	-2.3%	3,671,314	3,733,652	1.7%	72.8%	69.9%
Planning & Community Development	2,095,818	1,963,311	-6.3%	2,835,702	2,730,557	-3.7%	73.9%	71.9%
Police	12,152,026	12,482,865	2.7%	16,557,994	17,136,276	3.5%	73.4%	72.8%
Fire & Building	13,396,629	13,191,659	-1.5%	17,732,645	17,317,341	-2.3%	75.5%	76.2%
Total Expenditures	43,137,713	42,383,224	-1.7%	59,167,520	57,900,427	-2.1%	72.9%	73.2%
Other Financing Uses:								
Interfund Transfers	568,144	455,906	-19.8%	1,705,441	1,254,335	-26.5%	33.3%	36.3%
Total Other Financing Uses	568,144	455,906	-19.8%	1,705,441	1,254,335	-26.5%	33.3%	36.3%
Total Expenditures & Other Uses	43,705,857	42,839,130	-2.0%	60,872,961	59,154,762	-2.8%	71.8%	72.4%

Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

Personnel costs in most General Fund departments are down compared to last year due to the combination of the implementation of furloughs (which reduced salaries and benefit costs) and reduction in staffing as strategies to balance the budget in response to declining revenues (except for staffing added in anticipation of the annexation occurring in 2011—primarily in Police). In addition, specific factors for individual departments are noted below:

Comparing to the same period last year:

- Actual 2010 expenditures for the **City Council** are **3.1 percent ahead** of last year primarily due to a one-time citizen survey paid this year.
- Actual 2010 expenditures for the **City Manager's Office** are **11.3 percent lower** due to reduced facilities charges resulting from the purchase of the Municipal Court and lower professional services costs, such as the federal lobbyist (which was funded for 2009 only), as well as the timing of outside agency funding payments and other one-time 2009 expenditures.
- Actual 2010 expenditures for the **Parks & Community Services Department** are **5.7 percent lower** primarily due to the timing of human service agency grants and reductions to staffing levels.
- Actual 2010 expenditures for the **Public Works Department** are **6.4 percent lower** almost entirely due to staffing reductions and reallocations.
- Actual 2010 expenditures for the **Finance and Administration Department** are **2.3 percent lower** largely due to the previously mentioned furloughs and a one-time study in 2009, and despite one position added in anticipation of annexation.
- Actual 2010 expenditures for the **Planning and Community Development Department** are **6.3 percent**

(Continued on page 5)

Compared to 2009, 2010 General Fund actual expenditures are 1.7 percent lower primarily due to lower personnel costs and despite higher costs for jail costs and fire suppression overtime as noted in the explanation of Police and Fire Department expenditures.

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behind due to one-time 2009 costs for the Shoreline Master Plan update, as well as staffing reductions.

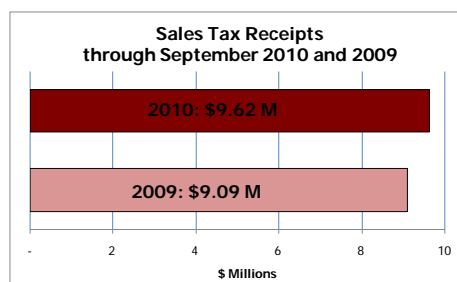
- Actual 2010 expenditures for the **Police Department** are **2.7 percent ahead** of the same period in 2009 due to personnel costs. Staffing will continue to be hired throughout 2010 in anticipation of annexation, which commences June 1, 2011. Total annexation personnel expenditures include planned increases for equipment and supplies for the new staff. Jail costs are 5.1 percent ahead of the same period last year. These costs have been a concern over the last few years. The City has negotiated new contracts with other agencies for lower rates than those charged by King County, although the total jail population and bed days continues to increase, causing the expenses to outpace the budget. The overage is expected to be offset by savings in other Police functions.
- Actual 2010 expenditures for the **Fire & Building Department** are **1.5 percent behind 2009** due to lower personnel costs largely due to reduced building staff resulting from declining development activity. Fire suppression overtime expenses in 2010 has exceeded the annual budget by more than 6 percent, however salary savings from a vacant Fire position and anticipated under-expenditures in other City departments are expected to help absorb the overage by year-end.



Juanita Beach Park Design

Sales Tax Revenue Analysis

Year-to-date revenue performance is **up 5.8 percent** compared to the same period last year, which is continuing the positive trend experienced for most of 2010. Strong performance in the automotive/gas retail and stabilized contracting revenue are the primary factors. However, the normalized increase drops a full percentage point to 4.8 percent ahead of last year when field recoveries (one-time collections resulting from Washington State Department of Revenue audits) are factored out. (see tables on page 6).



Business sector comparison to the same period last year:

- Auto/gas retail** is **up 19.2 percent** and remains the largest contributor to the improvement in sales tax performance this year. This sector had particularly strong performance May through July, but comparisons in August and September narrowed as a result of the spike in sales last year caused by the federal "cash for clunkers" program.
- Wholesale** is **up 40.4 percent** partially due to one-time field recoveries from audits by the Washington State Department of Revenue. Factored out, the sector would be up by about 27 percent, primarily due to the effects from the streamlined sales tax sourcing rules.
- Services** sector is **up 11.8 percent** primarily due to the impact from streamlined sales tax sourcing rule changes and also due to improvement to the accommodations sector, which is up 13.8 percent over 2009.
- Miscellaneous** sector performance is **up 5.3 percent** due to manufacturing, which is also probably the result of streamlined sales tax sourcing rule changes.
- Contracting** has stabilized from its free fall last year, **up 2 percent** primarily due to significant field recoveries. Factored out, the sector would remain positive, up about 0.6 percent. While improved from last year, this sector is 44 percent behind the same period in 2007 (about \$1 million).
- Other retail** remains positive for the second consecutive month, **up 6.5 percent** primarily due to gains from internet and catalog retail sales and a new grocery retailer, as well as the reclassification of one retailer from the general merchandise sector.
- Retail eating/drinking** is **down 5.5 percent** due to the closure of several restaurants and the impact of the recession. The opening of several new restaurants, along with improved performance from major businesses helped stabilize this sector's performance in September (reflecting sales activity in July).
- Communications** sector is **down 6.9 percent** due to changes in development-related activity as well as declining revenue from telecommunication service companies.
- General merchandise/miscellaneous retail** sector is **down 12.4 percent** and is the largest drain on revenue performance. The factors remain the same: disappointing performance by key retailers, as well as the reclassification of one significant retailer to another category. The impact from the streamlined sales tax sourcing rules has negatively impacted this business sector.

Streamlined Sales Tax

Washington State implemented new local coding sales tax rules as of July 1, 2008 as a result of joining the national Streamlined Sales Tax Agreement. Negative impacts from this change are mitigated by the State of Washington. About \$89,000 of revenue has been received for the first three quarters of 2010.

Neighboring Cities

Bellevue and Redmond 2010 sales tax revenue through September is down 5.2 percent and 3.3 percent respectively compared to the same period in 2009.

City of Kirkland Actual Sales Tax Receipts

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Business Sector Group	January-September		Dollar Change	Percent Change	Percent of Total	
	2009	2010			2009	2010
Services	1,082,181	1,210,067	127,886	11.8%	11.9%	12.6%
Contracting	1,270,541	1,296,511	25,970	2.0%	14.0%	13.5%
Communications	359,895	335,056	(24,839)	-6.9%	4.0%	3.5%
Auto/Gas Retail	1,877,103	2,238,213	361,110	19.2%	20.6%	23.3%
Gen Merch/Misc Retail	1,520,022	1,331,929	(188,093)	-12.4%	16.7%	13.8%
Retail Eating/Drinking	849,902	802,917	(46,985)	-5.5%	9.3%	8.3%
Other Retail	1,138,169	1,211,726	73,557	6.5%	12.5%	12.6%
Wholesale	409,526	575,109	165,583	40.4%	4.5%	6.0%
Miscellaneous	587,044	617,907	30,863	5.3%	6.5%	6.4%
Total	9,094,383	9,619,435	525,052	5.8%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2009 and 2010 year-to-date sales tax receipts in the table to the left.

City of Kirkland Actual Monthly Sales Tax Receipts

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2009	2010		
January	994,146	945,992	(48,154)	-4.8%
February	1,224,935	1,364,023	139,088	11.4%
March	954,492	937,460	(17,032)	-1.8%
April	867,726	953,914	86,188	9.9%
May	1,007,790	1,094,845	87,055	8.6%
June	900,630	1,009,111	108,481	12.0%
July	945,877	1,035,279	89,402	9.5%
August	1,091,599	1,136,223	44,624	4.1%
September	1,107,188	1,142,588	35,400	3.2%
Total	9,094,383	9,619,435	525,052	5.8%

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in September is for sales activity in July. Monthly sales tax receipts through September 2009 and 2010 are compared in the table above.

- Monthly revenue performance in 2010 has improved from the mostly double digit declines experienced throughout 2009.
- February 2010 was substantially ahead of February 2009 primarily due to significant improvements in auto/gas retail, other retail, and contracting. Revenue received in February is from activity in December, so it reflects an important part of the critical holiday shopping season.
- In addition to the economic recession, unusually severe winter weather experienced in December 2008 hampered holiday shopping, which negatively impacted February 2009 revenue.
- The impact of significant improvement in automobile sales and the softening of declines to contracting revenue are illustrated in the positive monthly trends experienced year to date.
- The dampening of automobile sales comparisons to last year caused by the "cash for clunkers" sales spike is indicated by the smaller gains in August and September.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Comparing to the same period last year:

Totem Lake, which accounts for over 30 percent of the total sales tax receipts, is **up 4.8 percent** primarily due to significant improvement in automotive/gas retail sales and despite the closure of a major retailer. Over 66 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for almost 16 percent of the total sales tax receipts, is **down 1 percent** primarily due to declines in the general merchandise/miscellaneous retail sectors and despite good performance in automotive/gas retail. These two sectors contribute over 85 percent of this business district's revenue.

Downtown, which accounts for 7 percent of the total sales tax receipts, is **down 4.3 percent** due to the loss of several retailers and declines in the retail eating/drinking sector. The retail eating/drinking, accommodations, and other retail sectors provide 68 percent of this business district's revenue.

tors provide 68 percent of this business district's revenue.

Carillon Point & Yarrow Bay, which account for 2.5 percent of the total sales tax receipts, are **down 0.3 percent** compared to last year primarily due to poor performance in the retail eating/drinking sector and despite positive performance in other retail and the accommodations sectors. About 70 percent of this business district's revenue comes from business services, retail eating/drinking and accommodations.

Houghton & Bridle Trails, which account for not quite 2.5 percent of the total sales tax receipts, are **up 2 percent** collectively almost entirely due to miscellaneous retail and other retail. A major supermarket was re-opened in May, which positively impacted this sector during the third quarter. These sectors provide over 71 percent of these business districts' revenue.

Juanita, which accounts for about 2 percent of the total sales tax receipts, is **flat** primarily due to generally stagnant performance across most sectors, with the exception of declines in personal and business services. Retail eating/drinking, miscellaneous retail and personal services provide almost 71 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that about 42 percent of the revenue received in 2010 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

Business District	Jan - Sep Receipts		Dollar Change	Percent Change	Percent of Total	
	2009	2010			2009	2010
Totem Lake	2,783,900	2,918,513	134,613	4.8%	30.6%	30.3%
NE 85th St	1,543,042	1,526,987	(16,055)	-1.0%	17.0%	15.9%
Downtown	704,434	674,158	(30,276)	-4.3%	7.7%	7.0%
Carillon Pt/Yarrow Bay	236,728	235,937	(791)	-0.3%	2.6%	2.5%
Houghton & Bridle Trails	224,039	228,530	4,491	2.0%	2.5%	2.4%
Juanita	203,606	203,605	(1)	0.0%	2.2%	2.1%
Unassigned or No District:						
Contracting	1,270,541	1,296,511	25,970	2.0%	14.0%	13.5%
Other	2,128,093	2,535,194	407,101	19.1%	25.6%	28.4%
Total	9,094,383	9,619,435	525,052	5.8%	100.0%	100.0%

Sales Tax Revenue Outlook Sales tax receipts have been positive for most of 2010 compared to 2009, but the positive trend has weakened in the third quarter, as illustrated in the monthly chart on the previous page. Additionally, one-time field recoveries have supplemented the increase by a full percentage point. Upside trends also pose potential risks—the automotive/gas retail sector has contributed the largest amount of gain, but this sector is very sensitive to economic conditions. Contracting has stabilized from the severe downturn it experienced last year, but it is also sensitive to the economy and revenue trends are much lower than just a few years ago. Performance in key retail sectors—general merchandise/miscellaneous retail and retail eating/drinking have not shown signs of recovery. The impact from streamlined sales tax sourcing rule changes has negatively impacted some sectors, but is offset by gains in others. The shaky economic recovery poses significant risk to the City's ability to maintain services, since sales tax remains the largest general fund revenue source this year. Changes in revenue structure over the last few years has provided some balance to offset the volatility inherent

OFFICE VACANCIES:

According to CB Richard Ellis Real Estate Services, the Eastside vacancy rate is 17.6 percent for third quarter 2010 which almost matches the same quarter last year (17.4 percent). Kirkland's 2010 vacancy rate is 25.1 percent.

The Puget Sound regional market recovery appears to continue with over 1 million square feet of positive absorption during the third quarter, with almost 40 percent occurring on the Eastside. Positive absorption occurs when the total amount of available office space decreases during a set period.

Sales of fully-leased office buildings also increased in the third quarter, including the City Center Plaza in Bellevue (occupied by Microsoft) for \$310 million.

Brokers agree that the market seems to be turning as big leases are being signed and companies are moving or expanding.

LODGING TAX REVENUE:

Lodging tax 2010 revenue is ahead 3.3 percent compared to the same period last year.

Economic Environment Update While the state economy continues to expand, the third quarter has slowed considerably after strong growth last spring. The private sector added 6,600 jobs during the quarter, but state and local governments shed 5,400, offsetting most of the private sector gains. The state's chief economist concurs with the national assertion that the recession has ended in Washington State, but recovery remains fragile and volatile. The state's latest economic and revenue update points out that while the recession may have ended, it only means that the economy has stopped shrinking and returned to modest growth. Instead of a double dip, there more likely will be "sideways" movement. The housing market is expected to remain depressed for quite a while due to foreclosures and hesitant buyers. Banking is also expected to struggle with more consolidations and failures. However, the latest *Puget Sound Economic Forecaster* is more upbeat about the local economy. It anticipates local employment growth above the national average in 2011 through the middle of the decade. Local industries, such as aerospace, software, and internet commerce, along with the area's strong connection to global trade, are expected to keep the region growing stronger than the rest of the nation.

The U.S. **consumer confidence index** dropped to **48.5** in September compared to 53.2 in August, primarily due to employment concerns. The monthly index changes have been particularly volatile in 2010, reflecting the uncertain economic conditions. An index of 90 indicates a stable economy and one at or above 100 indicates growth.

King County's **unemployment rate** is **8.4 percent** in September compared to 8.6 percent in September 2009. While remaining high, King County is lower than both Washington State and national rates, which are 8.6 and 9.2 percent respectively.

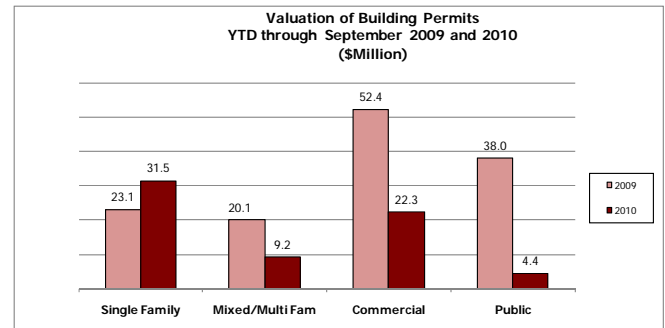
The **Western Washington chapter of Purchasing Managers survey index** short-term outlook rose to 59.2 in September from 58.0 in August. The long-term outlook index also rose to 57.2 from 56.9. An index reading greater than 50 indicates a growing economy, while scores below suggest a shrinking economy.

(Continued on page 8)

Local **development activity** through September comparing 2010 to 2009 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity remains improved in the single family sector. However, activity in the mixed use/multifamily, commercial and public sectors is low and the 2010 building permit valuation is 50 percent below the same period in 2009.

Closed sales of **new and existing single-family homes** on the Eastside are down 18.3 percent in September 2010 compared to September 2009, but the median price increased 3.5 percent (\$533,000 compared to \$515,000). Closed sales for condominiums were down 25.9 percent and the median price dropped 14.4 percent (to \$250,000 from \$292,000). September was the third straight month of year-over-year declines. September 2010 closed sales are at their lowest in five years. While home prices seem to have stabilized, there is some concern that slowing demand will create downward pressure on prices again.

Seattle metro consumer price index (CPI), for August was up 0.70 percent compared to August 2009. The Seattle metro CPI is calculated on a bi-monthly basis. This is in contrast to the national index, which was 1.4 percent in August and September. The June index was down 0.10 percent compared to June 2009 and is the contractual basis for budgeting 2011 COLA increases, which means that employees will receive no cost of living adjustment next year. While most economists believe the risk of deflation is remote, declining prices indicate that the economy is losing momentum. Deflation can cause dangerous downward pressure on the economy, as consumers avoid spending money hoping to buy goods later at lower prices.

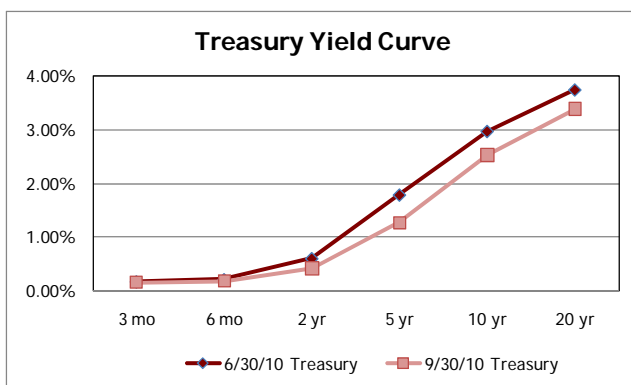


Investment Report

MARKET OVERVIEW

The Fed Funds rate remained at 0.25 percent during the third quarter of 2010, while the economy continued giving indications of a very slow recovery. The yield curve dropped slightly farther out on the curve, as can be seen on the graph below. The 2 year Treasury, already at historical lows, continued to decline as it moved from 0.61 percent on June 30, 2010 to 0.42 percent on September 30, 2010.

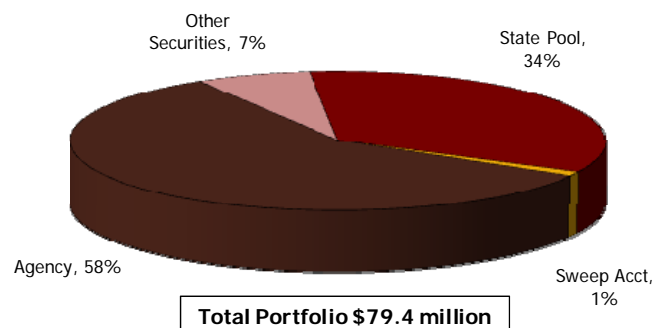
CITY PORTFOLIO



The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City.

The City's portfolio decreased in the 3rd quarter of 2010 to \$79.4 million compared to \$94.3 million on June 30, 2010. \$10.5 million of the decrease is due to the purchase of the Costco Home Property for the Public Safety building on September 1. The remaining decrease is related to the normal cash flows of the 3rd quarter, as the second half of property tax revenues is received at the end of October and early November.

Investments by Category



Diversification

The City's current investment portfolio is composed of Government Sponsored Enterprise (GSE's) bonds, State and Local Government bonds, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in U.S. Treasury or Federal Government obligations.

2010 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The outlook for growth in the U.S. economy looks weaker now than it did just three months ago, according to 36 forecasters surveyed by the Federal Reserve Bank of Philadelphia. The forecasters see real GDP growing at an annual rate of 2.3 percent this quarter, down from the previous estimate of 3.3 percent. On an annual-average over annual-average basis, the forecasters expect slower real GDP growth in 2010 and 2011. The forecasters see real GDP growing 2.9 percent in 2010, down from their prediction of 3.3 percent in the last survey. The forecasters predict real GDP will grow 2.7 percent in 2011 and 3.6 percent in 2012. The forecasters continue to see little threat of accelerating inflation. The unemployment rate is expected to average 9.6 percent in 2010 and fall to 9.2 percent in 2011. The Fed Funds rate, currently at 0.25%, is expected to remain at this level throughout 2010.

The duration of the portfolio will decrease as securities mature and are called. Opportunities for increasing portfolio returns are scarce as shorter term interest rates continue at historically low levels. New security purchases will be made as opportunities to obtain moderate returns become available. During periods of low interest rates the portfolio duration should be kept shorter with greater liquidity so that the City is in a position to be able to purchase securities with higher returns when interest rates begin to rise. The State Pool is currently at 0.30% and will continue to remain low as the Fed Funds rate remains at 0.00 to 0.25 percent. Total estimated investment income for 2010 is \$1.5 million. Interest earnings for the 2011-2012 biennium are expected to be \$1.3 million, less than the one-year earnings of 2010.

Investment Report *continued*

Liquidity

The target duration for the City's portfolio is the range between the 90 day Treasury bill and the 2 year Treasury note. The average maturity of the City's investment portfolio increased slightly from 1.3 years on June 30, 2010 to 1.5 years on September 30, 2010 primarily due to the decrease in short

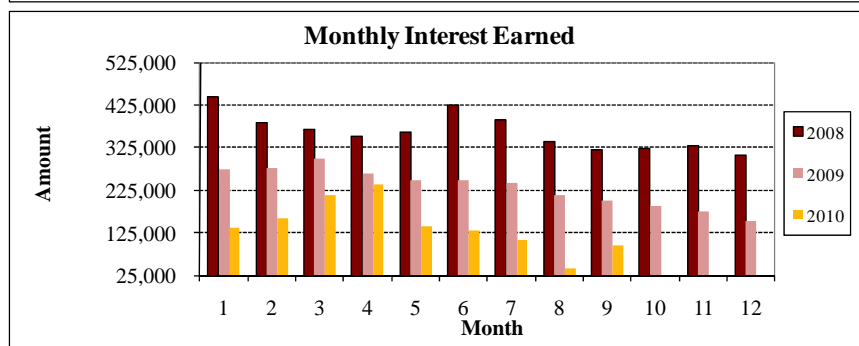
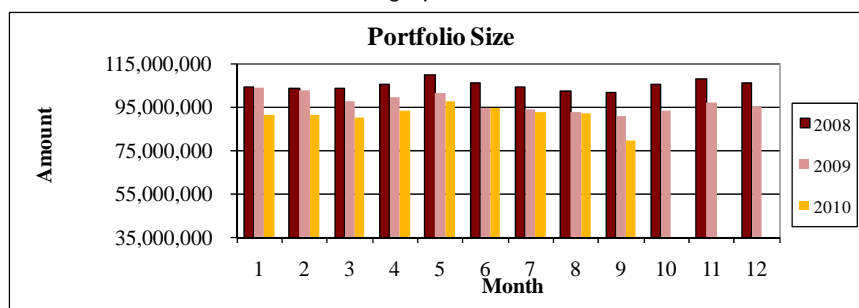
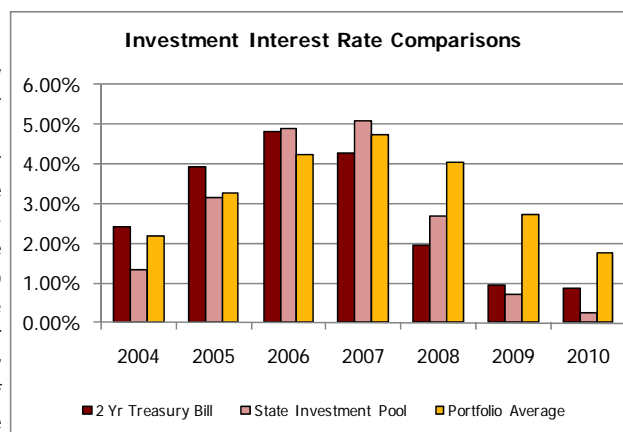
term investments (State Investment Pool and Sweep Account) with the purchase of the Public Safety building. It is expected that with the continuation of low interest rates, the portfolio duration will decrease as securities with call provisions will be called on their call dates.

Yield

The City Portfolio yield to maturity remained fairly level in the 3rd quarter moving from 1.58 percent on June 30, 2010 to 1.60 percent on September 30, 2010. The City's annual average yield to maturity declined to 1.75 percent during the same period. The City's portfolio benchmark is the range between the 90 day Treasury Bill and the 2 year rolling average of the 2 year Treasury Note. This benchmark is reflective of the maturity guidelines required in the Investment Policy. The City's portfolio

outperformed both the 90 day T Bill at 0.16 percent and the 2-year rolling average of the 2 year Treasury Note, which was 0.88 percent on September 30, 2010. The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the graph above.

Benchmark Comparison	June 30, 2010	September 30, 2010
City Yield to Maturity (YTM)	1.58%	1.60%
City Average YTM	1.89%	1.75%
City Year to Date Cash Yield	2.03%	1.77%
90 Day Treasury Bill	0.18%	0.16%
2 yr Rolling Avg 2 yr T Note	1.11%	0.88%



Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund at the end of the biennium.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

General Government & Utility Reserves Summary

Reserves	2009-10 Est End Balance	2009-10 Auth. Uses	2009-10 Auth. Additions	Revised 2009-10 End Balance
GENERAL PURPOSE RESERVES				
Contingency	2,324,515	607,837	320,600	2,037,278
General Capital Contingency	2,444,561	266,514		2,178,047
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	1,082,380	1,082,380		0
Building & Property Reserve	2,059,669	125,000		1,934,669
Council Special Projects Reserve	271,960	150,426	80,000	201,534
Total General Purpose Reserves	10,895,921	2,232,157	400,600	9,064,364
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	8,370,417	2,349,314	266,078	6,287,181
REET 2	8,134,095		361,336	8,495,431
Equipment Rental:				
Vehicle Reserve	6,421,787			6,421,787
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	494,373			494,373
Major Systems Replacement Reserve	247,900	200,000	197,600	245,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,051,963			1,051,963
Impact Fees				
Roads	3,429,578			3,429,578
Parks	237,809			237,809
Park Bond Reserve	558,981			558,981
Cemetery Improvement	523,405			523,405
Off-Street Parking	204,410			204,410
Tour Dock	70,175			70,175
Street Improvement	994,576	32,567		962,009
Firefighter's Pension	1,590,102			1,590,102
Park & Municipal Reserve:				
Litigation Reserve	51,329			51,329
Labor Relations Reserve	67,183			67,183
Police Equipment Reserve	48,093			48,093
LEOFF 1 Police Reserve	612,029			612,029
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	457,331			457,331
Tree Ordinance	28,980			28,980
Donation Accounts	161,257			161,257
Revolving Accounts	86,175			86,175
Water/Sewer Operating Reserve	1,799,424			1,799,424
Water/Sewer Debt Service Reserve	826,759			826,759
Water/Sewer Capital Contingency	3,018,240	239,200		2,779,040
Water/Sewer Construction Reserve	9,444,066	21,787		9,422,279
Surface Water Operating Reserve	394,485			394,485
Surface Water Capital Contingency	617,690			617,690
Surface Water-Transp. Related Rsv	1,302,179	38,126		1,264,053
Surface Water Construction Reserve	3,186,434			3,186,434
Total Special Purpose Reserves	55,817,225	2,880,994	825,014	53,761,245
Grand Total	66,713,146	5,113,151	1,225,614	62,825,609

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION	RESERVE	AMOUNT	DESCRIPTION
2009-10 Council Authorized Uses			2009-10 Council Authorized Additions		
Contingency	\$54,750	Verizon franchise negotiations	Contingency	\$50,000	Reimbursement from Verizon for franchise negotiations
	\$188,262	Hydrant Costs		\$270,600	Replenish reserve from 2009 General Fund expenditure savings
	\$272,000	2009 Firefighter Overtime			
	\$3,545	Return 2008 Interest Backfill to General Fund	Council Special Projects Reserve	\$80,000	Replenish reserve from 2009 General Fund expenditure savings
	\$89,280	Reserve Fire Fighter Compensation			
General Capital Contingency	\$64,000	Downtown Transit Center	Excise Tax Capital REET 1	\$266,078	Closed Capital Projects
	\$43,800	NE 73rd Street Sidewalk additional funding	Excise Tax Capital REET 2	\$361,336	Closed Capital Projects
	\$98,544	Return 2008 Interest Backfill to General Fund	Major Systems Replacement Reserve	\$197,600	Closed Capital Projects
	\$60,170	Pandemic Flu Supplies			
Revenue Stabilization Reserve	\$1,082,380	Backfill General Fund revenue deficit			
Building & Property Reserve	\$125,000	Return 2008 Interest Backfill to General Fund			
Council Special Projects Reserve	\$2,000	Council Retreat facilitator			
	\$26,000	Funding for federal lobbyist services for 2009			
	\$25,000	Funding for Neighborhood Connections in 2010			
	\$20,000	Hopelink relocation			
	\$13,770	Flexpass program			
	\$12,506	Bank of America project review process			
	\$5,000	Council special investigation			
	\$12,400	Medical transport fee consultant contract			
	\$20,000	ParkPlace Development Agreement Legal/Financial			
	\$13,750	Annexation Shoreline Master Plan Services			
Excise Tax Capital REET 1	\$2,349,314	Municipal Court Building purchase			
IT Major Systems Repl. Reserve	\$200,000	Permit Plan System replacement			
Street Improvement Fund	\$23,000	99th Place NE/100th Ave NE Sidewalk			
	\$9,567	2009 Annual Striping Program			
Water/Sewer Capital Contingency	\$54,000	Additional funding of \$54,000 for telemetry system upgrades at Supply Station #2 to coincide with a City-wide upgrade of telemetry panels at other water facility sites.			
	\$128,000	Funding for the completion of the 2009 Water System Improvement Project.			
	\$17,200	NE 73rd Street Sidewalk (watermain replacement) additional funding			
	\$40,000	3rd Street Watermain Replacement			
Water/Sewer Construction Reserve	\$21,787	Bridle View Annexation Water System Purchase from Reimbursement			
Surface Water-Transp. Related Rsv	\$23,000	Downtown Transit Center (surface water component)			
	\$15,126	NE 124th Street/124th Ave NE Intersection Improvements (surface water component)			

General Government & Utility Reserves Targets Summary

Reserves	Revised 2009-10 End Balance	2009-10 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,037,278	4,915,571	(2,878,293)
General Capital Contingency	2,178,047	9,032,430	(6,854,383)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,567,649	(854,813)
Revenue Stabilization Reserve	0	2,188,803	(2,188,803)
Council Special Projects Reserve	201,534	250,000	(48,466)
General Purpose Reserves with Targets	7,129,695	19,954,453	(12,824,758)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	6,287,181	1,653,500	4,633,681
REET 2	8,495,431	8,477,130	18,301
Firefighter's Pension	1,590,102	1,103,000	487,102
Park & Municipal Reserve:			
Litigation Reserve	51,329	50,000	1,329
Water/Sewer Operating Reserve	1,799,424	1,799,424	0
Water/Sewer Debt Service Reserve	826,759	826,759	0
Water/Sewer Capital Contingency	2,779,040	3,018,240	(239,200)
Surface Water Operating Reserve	394,485	394,485	0
Surface Water Capital Contingency	617,690	617,690	0
Special Purpose Reserves with Targets	22,841,441	17,940,228	4,901,213
Reserves without Targets	32,854,473	n/a	n/a
Total Reserves	62,825,609	n/a	n/a

The summary above details all Council authorized uses and additions to each reserve for the biennium through September 2010.

Use of the Revenue Stabilization Reserve was part of the budget-balancing strategy for the 2009-10 biennial budget. Replenishment of this reserve will be the first priority for use of available year-end funds.

The table to the left compares the revised ending balance to the targets established in the budget process for those reserves with targets.



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- ◆ Tammy McCorkle, Budget Analyst

www.ci.kirkland.wa.us

The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a **summary budget to actual comparison** for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis** report takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

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- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- City of Kirkland Building Division
- City of Kirkland Finance & Administration Department